



Quarterly Economic Update

November 28, 2007



MACROECONOMIC COMMENTARY

Monetary Policy

By Lance Lachney

At the time of our last meeting, the Federal Reserve had just lowered the discount rate 50 basis points to 5.75%. This move, which provides better access to funding by banks and depository institutions, was in response to a global credit crunch that had temporarily caused overnight lending rates to soar. The debate began on whether the change at the discount window would buy the Fed time before its September meeting or if it was a precursor to an inter-meeting move. Ben Bernanke and policymakers did not provide an immediate cut in the federal funds rate, opting to wait until the September 18 meeting. At this gathering, the Federal Reserve lowered short-term interest rates by 50 basis points, somewhat of a surprise to the capital markets which for the most part was forecasting only a 25 bps ease. In its statement, the committee stated that the “tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth.” In English, they had become concerned that current conditions would ultimately lead to slower growth in consumer spending that would cause an economic downturn.

Since the Fed’s September action, the economic climate has gotten worse. Equity markets have stumbled, interest rates have fallen, commodity prices have soared, and most importantly, the confidence of the consumer, which is such an integral part of the economy, has dropped. Policymakers once again opted to lower short-term interest rates at its Halloween meeting (October 31). In the FOMC statement, the committee noted that “economic growth was solid;” however it also stated that the expansion would likely slow in the near term due to a downturn within the housing sector. The Fed also recognized the increases in energy and commodity prices that could put upward pressure on inflation. In conclusion, the text stated that the “upside risks to inflation roughly balance the downside risks to growth.”

In mid-November, Federal Reserve Chairman Ben Bernanke announced several changes in the way the committee communicates with the investing community. Going forward, the Fed will release its economic forecasts four times a year (two semi-annual reports in February / July and two forecasts scheduled after the 2008 April and October FOMC meetings). It will also extend the forecast horizon by an additional year. While the core PCE continues to be the Fed’s preferred price gauge, it will add headline inflation (PCE deflator) to its forecast. The Fed still views core inflation (excluding food/energy) as a better measure of underlying inflation trends; however, many in the investing public have argued that food and energy should be included in economic forecasts as the two make up a huge portion of consumer budgets. Estimates of nominal GDP will also be eliminated on a going-forward basis. The Chairman stated that these changes will provide a “more-timely insight” into the committee’s outlook and help households and businesses better understand and anticipate policy decisions. Bernanke also said the projections would function in three ways: “as a forecast, as a provisional plan, and as an evaluation of certain long-run features of the economy.”

Recent Fed commentary suggests that the committee is in a “wait-and-see mode”. These are the words from the Federal Reserve Bank of Kansas City President Thomas Hoenig. Hoenig cast the only dissenting vote at October’s policy meeting in which the committee lowered the federal funds rate by 25 bps to 4.50%. It has been revealed that only six of the twelve Federal Reserve Banks requested this move. The treasury yield curve has steepened dramatically during this time with the spread between 2s and 10s gapping out to 82 bps from 35 bps in less than two months. Fed futures are currently pricing in a 96% chance of additional easing at the December meeting. Bernanke himself declared that economic growth will “slow noticeably” in the near future. However, he and policymakers are cognizant about the effects of higher commodity prices and a weak currency. While few have suggested that stagflation (sluggish growth coupled with a high rate of inflation and unemployment) may be upon us, the labor market seems to be holding it together for the moment. We believe the employment picture will be the Fed’s main focus going forward in regard to policy decisions. At the moment, the housing recession has not filtered down into the employment numbers. Policymakers currently have a favorable employment outlook. We are less confident.

Fiscal Policy

By Nick Prillaman

According to the estimates of the Congressional Budget Office (CBO), the federal budget deficit was about \$161 billion for the 2007 fiscal year, which was \$87 billion less than the shortfall recorded in 2006. On a relative basis, the deficit was roughly 1.2 percent of GDP, which was an improvement from the 1.9 percent in 2006. Receipts from withheld individual income and payroll taxes, the largest source of income and payroll taxes, grew by \$107 billion, or 6.7 percent. Those gains were mainly due to continued growth in wages and salaries. Corporate income taxes grew by about \$18 billion, or 5 percent, as estimated by the CBO. This figure is indicative of a distinct slowdown from the previous three years, which had growth averaging 39 percent per year. In terms of outlays, spending on Medicare and Medicaid continued to grow rapidly, increasing 9 percent from fiscal 2006. Defense and Social Security spending both increased 6 percent in 2007 after posting similar gains in 2006. Net interest outlays grew 6 percent as debt levels and interest rates continued to increase for much of the year.

	FISCAL	YEAR	TOTALS
	(Billions of dollars)		

	Actual FY2006	Preliminary FY2007	Estimated Change
Receipts	2,407	2,568	161
Outlays	2,655	2,729	74
Deficit	-248	-161	87

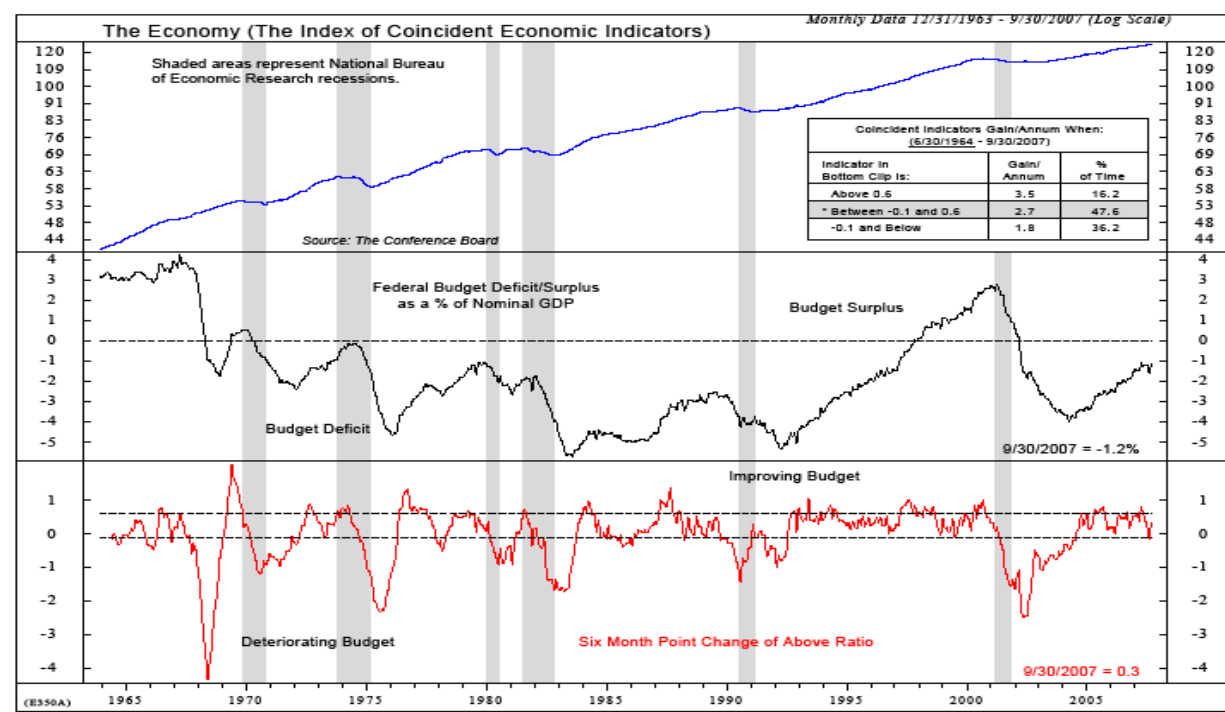
Sources: Department of the Treasury;
CBO.

In July, the federal government recorded a deficit of \$37 billion. Overall receipts for the month were about \$10.5 billion, or 7 percent higher than July 2006. The improvement can be explained by higher withholding for individual income and payroll taxes. While corporate income taxes were lower for the month, it is not unusual given that only a small percentage of corporations pay income taxes in July. Outlays increased 8% to \$15 billion from the previous year, as defense spending accounted for the strongest growth which was up 14 percent. Medicare spending also grew 13% after adjusting for timing shifts.

In August, the deficit was \$115 billion, which was \$50 billion more than the shortfall from a year earlier. Receipts were 8% higher to \$12 billion which can be explained by higher withholding for individual income and payroll taxes. Corporate income tax receipts were \$3 billion lower than they were last year. Outlays were larger during the month of August due to two non-recurring circumstances which added \$62

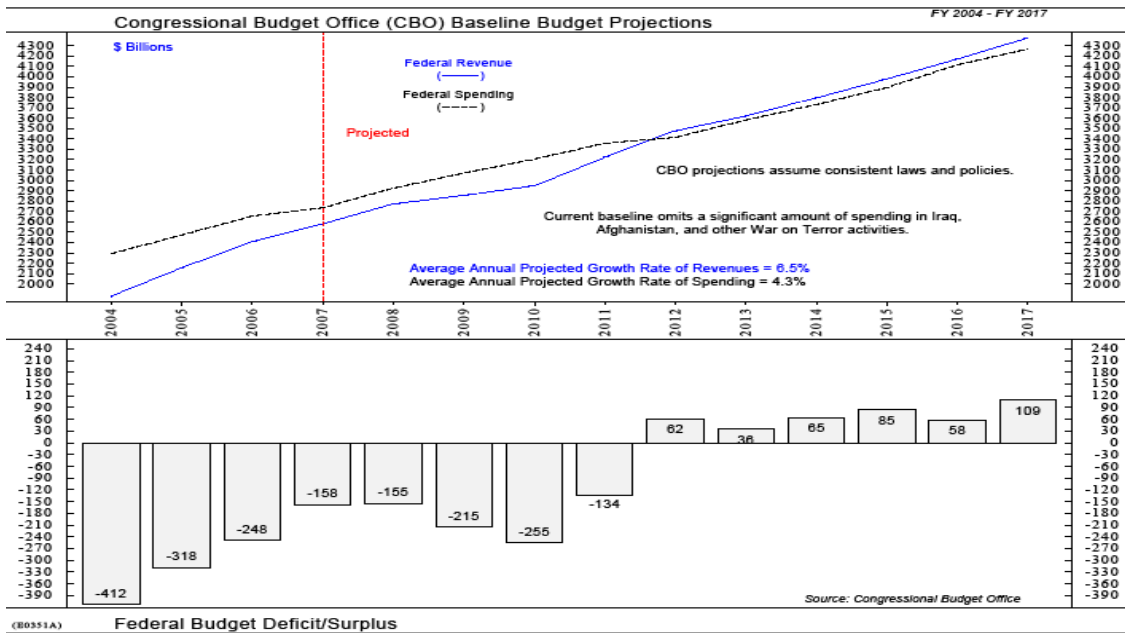
billion to the total. The first issue dealt with recognizing \$43 billion in the month of August rather than September because the first two days of September fell on a weekend. Social Security benefits in the amount of \$25 billion were a portion of this early payment plan. The second issue was an accounting adjustment that reduced August 2006 outlays by \$6 billion. Without these two matters, spending in August would have grown approximately 6 percent from the previous year.

In September, the U.S. government produced a budget surplus of \$113 billion, which was \$57 billion more than the same month last year. The surplus is typical for this time of year as revenues from quarterly tax payments come in. It was also aided by the recognition of \$43 billion of outlays in August due to changes in the calendar. Receipts for the month were 1 percent higher when compared to last year. Corporate income tax receipts fell approximately \$8 billion, or 9 percent, which can be partially explained by the weaker growth in corporate profits this year. Withholding for individual income and payroll taxes showed a smaller gain of \$3 billion, or 2 percent.



Source: Ned Davis Research, Inc.

As one can observe from the graph above, the federal government continues to make strides in reducing the U.S. budget deficit from the cyclical lows of 2004. The Congressional Budget Office is predicting that budget surpluses will begin in 2012 which is referenced by the chart on page 6. Risks to this projection include slowing corporate and individual tax receipts due to restrained economic performance and ever increasing outlays for unfunded social liabilities.



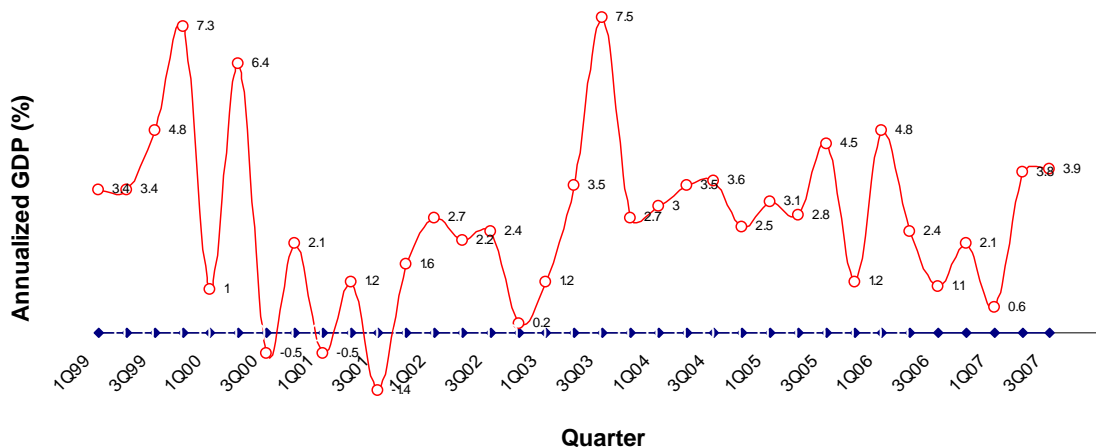
Source: Ned David Research, Inc.

Economic Outlook

By Keith Buchanan

The annualized gross domestic product (GDP) for the third quarter of 2007 was 3.9%, up from 3.8% the prior quarter and handily topping the consensus expectation of 3.1%. The economy grew at a faster pace than in any quarter since the first quarter of 2006. The upside surprise can be attributed to an acceleration of personal consumption expenditures (PCE) and net exports. A deceleration in nonresidential structures, a larger decrease in residential fixed investment, and increased imports all weighed on real GDP this quarter.

Annualized Gross Domestic Product



Source: Bloomberg, US Department of Commerce

Real PCE increased 3% this quarter, significantly higher than the 1.4% increase posted a quarter earlier. This upswing in PCE shows that the consumer has not shied away from spending. Every segment of PCE grew this quarter, with spending on durable goods, nondurable goods, and services increasing to 4.4% from 1.7%, 2.7% from -0.5%, and 2.9% from 2.3%, respectively.

Gross private domestic investment grew at a much slower pace of 0.8% this quarter, down from 4.6% last quarter. The only segment of gross private domestic investment that did not grow at a slower rate was the investment in nonresidential equipment and software. Fixed investment in nonresidential structures and residential investment grew at a slower pace than last quarter. This indicates the caution in the psyche of business management teams.

The headline upside surprise in the third quarter GDP report was the growth in net exports. Exports rose 16.2%, compared to a 5% increase in imports. This glass could be viewed as half-full or half-empty. On one hand, the better-than-expected growth in exports showed that the global economy is still very robust, and the depreciated U.S. dollar boosted global interest in goods that were made

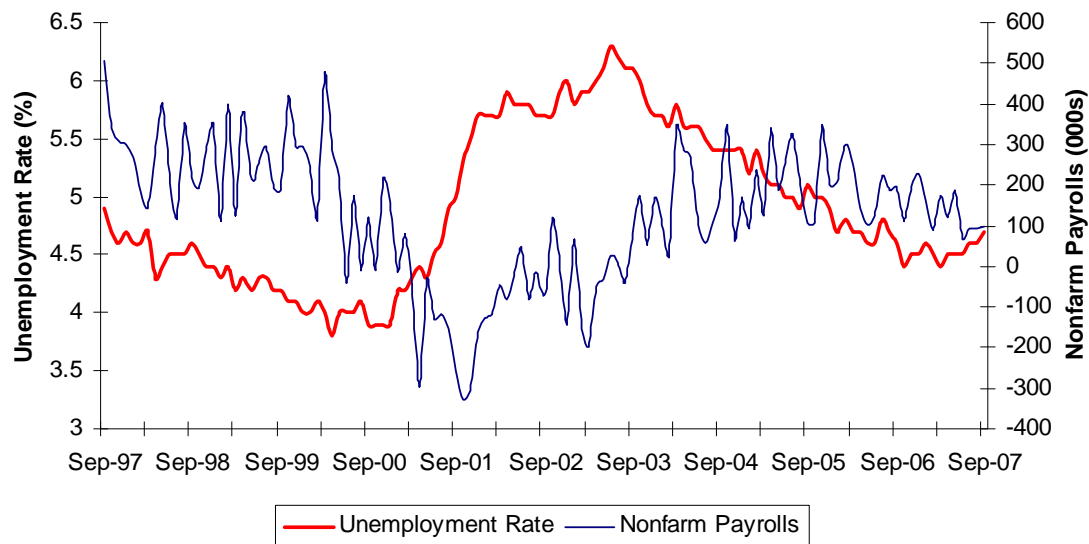
domestically. However, the relatively slower growth in imports highlights the slowdown in U.S. final demand growth.

As economists expected economic growth to slow from the 3.8% increase last quarter to 3.1% in the third quarter, this quarter came as a surprise to the markets. Most expected housing and the impending credit crisis to have a more widespread impact on consumer and business spending. However, the third quarter's results seem to imply that the economy continued to grow at a strong pace, at least for now it was contained at least for this quarter. Only time will tell if this can continue, but it was a bittersweet realization for the markets. Better-than-expected domestic growth in the U.S. will be taken into consideration at the Federal Reserve's Federal Open Market Committee meetings as they ponder the status of the current economy and the need for further accommodative measures.

Inflation as measured by the consumer price index excluding food and energy (core CPI) has been ratcheting down to levels closer to the 1 to 2% comfort zone that was stated earlier by Federal Reserve Chairman Ben Bernanke. The index was at 2.2% for each month of the third quarter. In July, the prices for core goods rose sequentially for the first time since February, but increased only 2.2% over the prices from last year. Core services, shelter prices, and owner's equivalent rents all increased over 3%, and tuition costs rose over 5% compared to the same month last year. In August, the core CPI took another leg down to a 2.1% increase in prices, the slowest pace in 17 months. Core goods prices did not change from the same month last year, as increases in apparel prices and vehicle prices were offset by a decrease in the prices of household furnishings. Core services prices rose 3.2%, as shelter prices, owner's equivalent rent, and medical care services prices rose 3.5%, 3.0%, and 5.5%, respectively. September's core CPI followed a similar path as it was posted at 2.1% and was driven by increased prices in core services.

The demand for labor slowed somewhat this quarter, but remained at a healthy level. The economy added 282,000 jobs this quarter, which is the lowest quarterly total since the third quarter of 2003. However, the unemployment rate stayed low, perhaps buoyed by the strong payroll increases in the prior quarters. This would lead us to believe that the unemployment rate in coming quarters could rise to a level that is more comparable with the recent lower payroll increases.

Unemployment Rate and Nonfarm Payrolls



Source: Bloomberg, Bureau of Labor Statistics

In July, payrolls increased by 93,000 jobs and the unemployment rate rose to 4.6%, compared to expectations of an increase of 127,000 jobs and an unemployment rate of 4.7%. Household employment declined from a 197,000 improvement in June to a 30,000 decline in July. In August, a very negative jobs report was released and revised upward in the following month's report. The Department of Labor Statistics originally posted a decrease of 4,000 jobs in August, which would have been the first monthly decrease in jobs since 2003. All market participants were surprised by this as the consensus expectation called for an increase of 100,000 jobs. The October report revised August payroll results up to an increase of 89,000 jobs. The biggest outlier between the original report and the revised results was the swing of 85,000 government jobs. The actual final August result ended up being 93,000 jobs added and a 4.6% unemployment rate. September results came in 4,000 jobs shy of consensus expectations at 96,000 and a 4.7% unemployment rate. Construction employment fell in September, as it did in every other month this quarter.

The culprit for much of the consumer's concerns and the credit shakeout is the housing market. Every morsel of data coming out of the housing market confirms that the downturn is upon us. Pending home sales posted its largest decline ever when it had 10.7% fewer sales in July 2007 than in July 2006. August and September's pending home sales were better than July, but not high enough to suggest that July's result was an anomaly. The National Association of Home Builders Index, which reflects the confidence of homebuilders, ticked lower each month, making a new all-time low in October. Housing starts, as calculated by the U. S. Commerce Department's Bureau of the Census, also ticked lower each month to establish a new 14-year low in September. Building permits, as one would expect, followed the same trend, reaching a 14-year low in September. Existing home sales made an all-time low in September, as its measure has been

in existence only since 1999. Nonetheless, this is an important gauge of the housing market because it shows how many current homes actually changed hands. The list goes on and on for barometers of the housing market that are seeing either unprecedented levels or levels that have not occurred since 1993. Imagining the potential impact on the economy is a very disturbing exercise, and domestic and international markets alike are resting their hopes on the containment of any carnage caused by this housing downturn. There will be an obvious squeeze on the consumer as the equity in his home can no longer be depended on as supplemental capital. Retail sales have been weaker as of late. The upcoming holiday season will speak volumes for the current financial situation of the U.S. consumer, but even more for his perspective of the financial situation going forward.



Source: Bloomberg, Conference Board

The more pertinent exercise is to examine the sentiment of the economy, on both the business and consumer sides. In September, consumer confidence, according to the Conference Board's Consumer Confidence Index, declined for the second consecutive month after posting a six-year high mark in July. However, the index remains at an elevated, healthy level. There is no doubt that the current housing market and the recent headlines on the issues in the credit market had a part to play in the disappointing results for September. The reading for planned spending components in September showed this as plans to buy a house fell into the bottom 5% of its range. Plans to buy an automobile fell to the bottom 15% of its range. The September report also reflected some similarities to other recent economic readings. In general, the consumer feels that employment is good, business

conditions are favorable, and jobs are plentiful. However, they do not feel that business conditions or job opportunities will increase much. The lack of enthusiasm to make two of the largest purchases that the consumer can make also sounds an alarm. It reveals a comfortable, yet hesitant consumer that may be adopting a “wait and see” approach to their immediate and intermediate spending plans.



Source: Bloomberg, Conference Board

On the other hand, business confidence, as measured by the Conference Board, has not been at a lower level since the fourth quarter of 2001. This is very interesting to put in perspective and consider all that was going on at that time. The United States was just 20 days removed from the attacks of September 11 when the quarter began. This survey was taken in the quarter that succeeded the third quarter of 2001 which posted a GDP result of -1.4%, the worst quarterly slowdown since the recession of 1991. The S&P 500 posted earnings growth of -26% over the same quarter in 2000. The S&P 500 also took a 30% haircut in the seven months following the fourth quarter's end. We definitely have some pressing issues now, but the current economy is much healthier than it was in the fourth quarter of 2001. With all the peril that surrounded the fourth quarter of 2001, are businesses rightfully this negative? It only seems rational for there to be a convergence of the sentiments of businesses and their consumers. The hope is that businesses become more positive going forward and the consumers do not close their wallets.

RSA PORTFOLIO STRATEGY

Interest Rates and Fixed Income Strategy

By Julie Barranco

Volatility has continued its presence in the bond market since our last meeting. At that time we spoke about the decline in Treasury yields and the steepening of the yield curve as negative headlines from the sub-prime mortgage market moved to the forefront of the credit sector once again. Fed Fund futures were predicting a 100% chance of a 25 basis point rate cut in September and likely more cuts later in 2007. The Fed did not disappoint, and lowered the Fed Funds rate 50 basis points at the September meeting along with another discount rate cut as well. The equity and credit markets showed their relief by rallying significantly over the next few weeks on the belief that the credit crisis was behind us.

As we entered October, the markets seemed to have normalized – the supply pipeline was open and functioning smoothly while secondary trading volumes were robust as well. Spread markets were performing well with the corporate and mortgage sectors outperforming other high grade sectors. As earnings announcements from the banks and brokers began later in the month, the significant amount of write-downs related to leveraged loan commitments and structured product vehicles at several of the largest financial institutions caught some investors off guard. These earnings releases combined with the many rating agency downgrades of structured vehicles due to the questionable values assigned to them, reignited investor fears about the potential for further damage in this sector.

Because the problems in the sub-prime mortgage markets have been ongoing for several months, we thought it worthy to review what is going on within this sector once again. Sub-prime loans are of low credit quality and therefore bear more risk to the companies that issue them. A large portion of these loans were issued a few years ago when short-term rates were much lower and the housing market was much stronger. As short-term rates rose and the housing market softened, the default rate on these types of loans rose. Many of these types of loans were included in pools of collateral used in CDO and other structured product offerings; as the default rate on the lower quality loans in these pools has risen, the credit rating agencies have begun downgrading these issues and the market values have fallen, resulting in losses to investors as well as financial institutions that hold them.

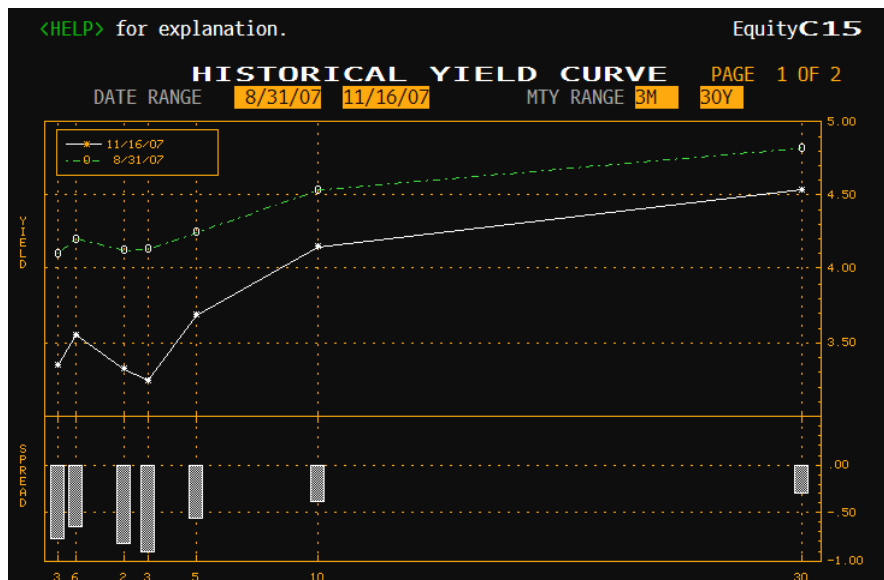
On a related note, banks' exposure to SIVs (Structured Investment Vehicles) has hurt their performance as well. SIVs are off-balance sheet funds that invest in longer dated, high yielding mortgage securities and finance company bonds with cash raised by issuing short term debt such as commercial paper and medium term notes. The banks make money by earning more from their investments than they pay to fund them, as well as from the fees to administer them. However, selling commercial paper has grown increasingly difficult in recent months as the

subprime market has eroded; if SIVs cannot refinance maturing commercial paper, they may have to sell off assets. In fact, these vehicles are required by ratings agencies to sell their assets if they lack the cash to pay back investors. With many SIVs being exposed to mortgage assets, which have declined in value, the concern is that any assets sales may not generate enough proceeds to pay off these investors.

This turmoil in the mortgage and mortgage-related sectors led to significant spread widening in the financial sector toward the end of October. However, strength in the industrial sector allowed spread levels overall to essentially end the month unchanged.

Treasury yield levels were stable during the month, declining only modestly across the curve. The shape of the yield curve was static, with the 2-year/10-year differential holding steady at around 53 basis points.

November got off to a rough start with high grade and high yield credit spreads widening out significantly within the first two days of the month. While the equity and credit markets had responded well to the 25 basis point rate cut on October 31, views on the market seemed to literally change overnight. While the equity markets sold off, credit spreads began widening again as well; the sub-prime markets, soaring oil prices, a weaker dollar and concerns about the economy's health all contributed to investor dismay. Through mid-month all spread sectors were underperforming versus Treasuries, which have benefited from a flight to quality. Yields on the short end of the Treasury curve have declined roughly 40 basis points while yields on the longer end have declined nearly 20 basis points. This has caused the yield curve to steepen further, from 53 basis points at the end of October, to around 83 basis points currently.



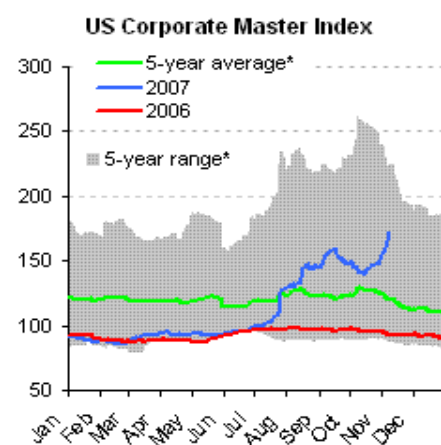
Source: Bloomberg

The chart on page 13 details the changes in the yield curve since our last meeting, and clearly depicts the significant decline in yields and further steepening that we have experienced.

Despite the 75 basis point cut in rates that the Fed has delivered since September, Fed Funds futures currently predict a better than 80% chance of an additional 25 basis point cut in December.

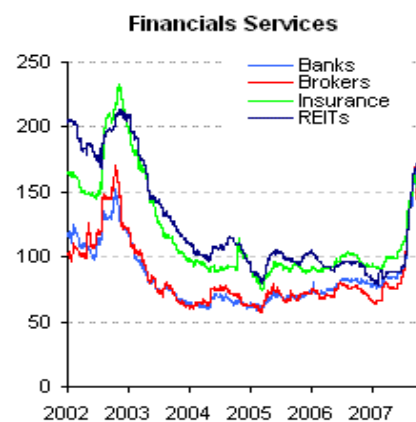
Looking at sectors within the bond market, we have seen spread product continue to lag over the past 3 months. While we saw spreads retrace some of the widening experienced over the summer in late September and early October, Treasuries have far outperformed other high grade sectors during the second half of the year. The agency and mortgage sector have held in fairly well, with only marginal spread widening over this time period mainly in response to moves in swap spreads. High yield corporate bonds underperformed substantially over the last few months although we have seen a bit of new issuance and secondary activity return to this sector recently. Within the high grade corporate bond sector, we have experienced a large degree of volatility as mentioned earlier. While spreads across all industries within this sector have widened, the financial sector has been hit the hardest as the broker/dealers and banks have been hurt by their exposure to sub-prime mortgages and the subsequent write downs taken. It is highly likely that these write downs are only the “first round” and that additional write downs will be announced in the coming quarters. A few of the broker/dealers and many of the mortgage lenders and insurers have had their debt ratings downgraded as a result; we expect more downgrades in the coming months as well.

As was the case last quarter, the main concern within the bond markets is the turmoil in the mortgage markets and fears of a credit crunch. Wider spreads and increased volatility are expected to continue in the coming months, particularly in the financial services sector. The charts on page 15 depict the spread changes within the high grade corporate sector as a whole and the Financial Services sector over the last five years. Corporate spreads are currently well above their 5-year average levels and Financial Service spread levels are at the widest levels since late 2002.



* 2002 - 2006

Source: ML Indices (CQAO), CreditSights



Source: ML Indices (COPD, CFBR, CFIS, CIRE)
CreditSights

	Nov 9 2007	Change (bp)		
		Week	Month- to-date	Year- to-date
High Grade	172	15	22	81
Financials	191	23	34	114
Non-Financials	158	8	13	55

Source: Creditsights

	Nov 9 2007	Change (bp)		
		Week	Month- to-date	Year- to-date
Banks	204	26	38	125
Brokerage	205	36	51	139
Insurance	172	12	18	78
REITs	203	20	24	120

With this in mind, we have kept our corporate weighting flat versus last quarter. Issues added were higher quality names in the bank, pharmaceutical and oil and rail sectors, continuing our strategy over the last few quarters of buying larger, more liquid issuers that should provide more stable performance during downturns in the credit markets. Most of our purchases have been in the short to intermediate part of the curve so as to keep duration neutral to slightly short in this sector for now. Other than a few of the larger broker/dealers, the corporate bond portfolio has been largely insulated from the poorest performing industries as we have little to no exposure in these companies.

We were somewhat active within the agency portfolio during the quarter. We sold out of some very short term issues and purchased slightly longer dated issues in order to better position the portfolio for the steeper yield curve. The duration of the agency portfolio has basically been in line with that of the index. However, with implied volatility much higher than a couple of months ago, some callable structures offer good value currently and we may selectively add to this sector as opportunities arise.

We made no changes within the Treasury portfolio during the quarter as we were positioned well for the steepening yield curve. Going forward we may look to add to this sector along with spread sectors as attractive opportunities arise.

Domestic Equity Strategy

By Marc Green

Fiscal year 2007 proved to be better than many expected. Despite numerous headwinds, the stock market was able to look through the trouble and managed to post at least mid-teen gains across the board. Valuations continue to be reasonable, especially relative to what is available in the bond market. The S & P 500 is currently trading at 14.5X 2008 consensus estimates, which historically has been a decent environment for stocks. Looking at the chart below, you can see that volatility has picked up this year. The VIX index, which is a measure of short term volatility, has nearly tripled off the lows established in the first quarter of the year.

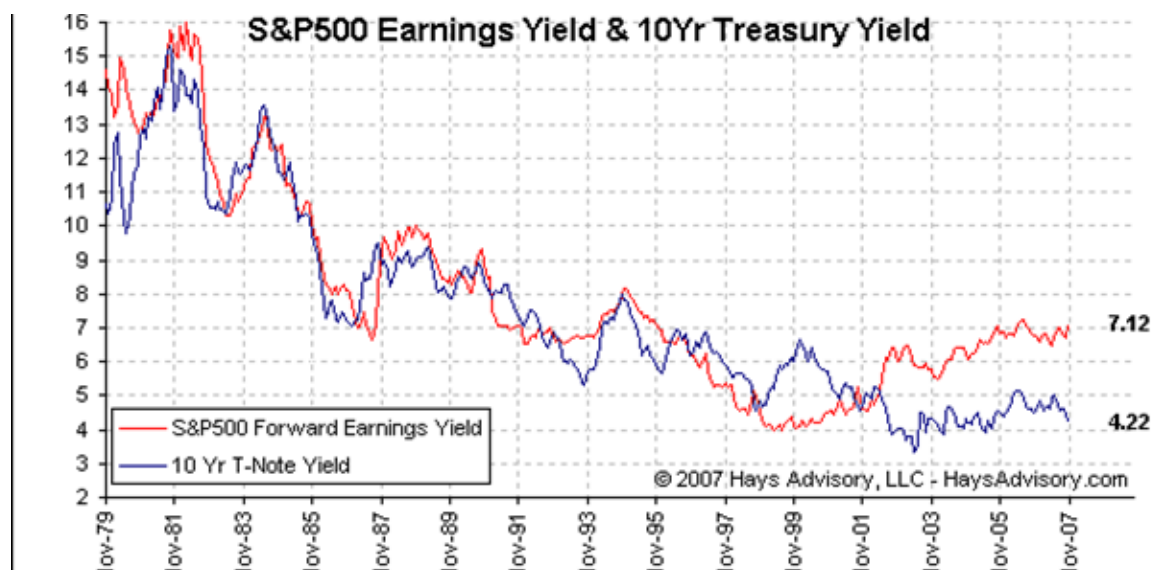
Chart1
S&P 500



One of the big questions right now is how the economy is really doing. Obviously, things are slowing, and yes, the Federal Reserve is cutting short term rates. Third quarter GDP growth looks to be coming in around the 5% range, yet the next couple of quarters will probably be closer to 1%. It has been amazing how fickle investor sentiment has been this year. A couple of months ago, the market mantra was that the Fed was going to save the day, and you want to own all the growth and internationally leveraged names. Now, investors have become much more risk averse after realizing that in all likelihood, earnings estimates for the 4th quarter and 2008 are probably too high. Along those lines, there is the school of thought that the Fed is way behind the curve in cutting rates. The marketplace has become enamored with guessing what the Fed course of action will be from one meeting to the next. As we laid out in earlier pieces, we believed the Fed would be cutting rates late in 2007. Not many would have guessed it would be because of a credit crisis, however.

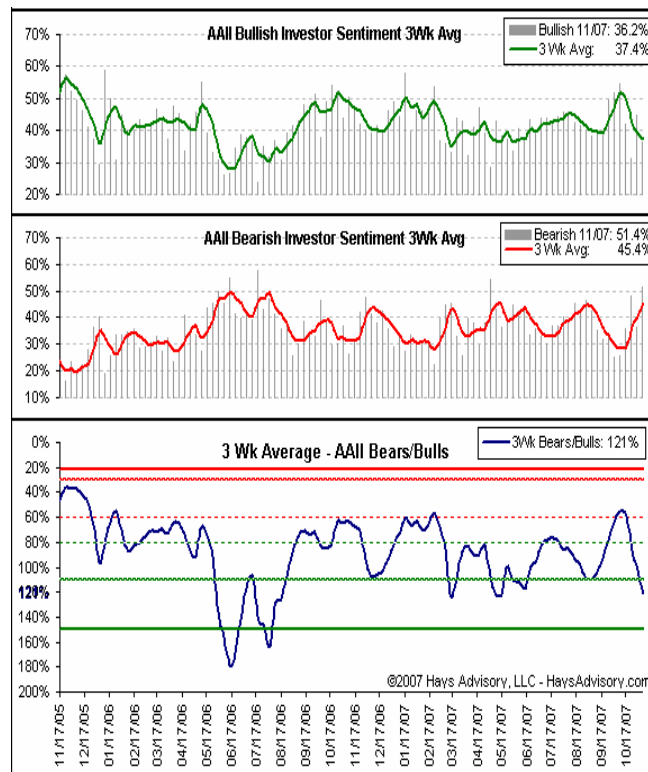
As we mentioned earlier, we are still constructive on the stock market. Putting a pen to paper, the number of negative variables far outweigh the positives. Yet, the heaviest weighting in our books is valuation, and it is one is pretty compelling. The stock market, trading at 14.5X forward estimates, is back to the levels it traded at coming out of the bear market in early 2003. Relative to bonds, stocks look pretty attractive. The chart below, courtesy of Hays Advisory, shows the earnings yield of the S&P 500 relative to the 10 Year Treasury. As you can see, the gap is as wide as it has been in the 28 years included on this chart.

Chart 2



We usually like to address investor sentiment towards the market and use it as a barometer for the short term. Lately, sentiment shifts have been fast and dramatic as alluded to above. It is not hard to envision this type of environment hanging on for awhile. Much of the recent volatility has been driven by continued negative news regarding subprime mortgage issues, and we believe that this is not going away soon. By some estimates, the peak in subprime resets is not due until 2Q 2008 at the earliest. With that in mind, the market probably remains choppy with sharp rallies on good news and decent valuations, followed by sharp pullbacks on negative announcements like those given recently by the brokers. The following chart shows how quickly opinions have changed at the retail investor level.

Chart 3



The concerns are easy to see, as they are all over the media. Oil prices have continued to climb, nearly touching \$100 per barrel. Obviously, this is another burden on the consumer, which accounts for roughly 70% of GDP. Also, what homeowners thought their house was worth continues to decline, and at the same time a lot of homeowners mortgage payments are rising upon reset. This is not a good combination. Commodity inflation has continued pretty much unabated the past couple of years. Food prices have been rising as a result, especially in the developing markets. The U.S. dollar continues to depreciate against most other major currencies. There has been and will continue to be much politicking regarding the slide in the dollar. The following chart provided by ISI shows the trade weighted dollar over the past 30 years.

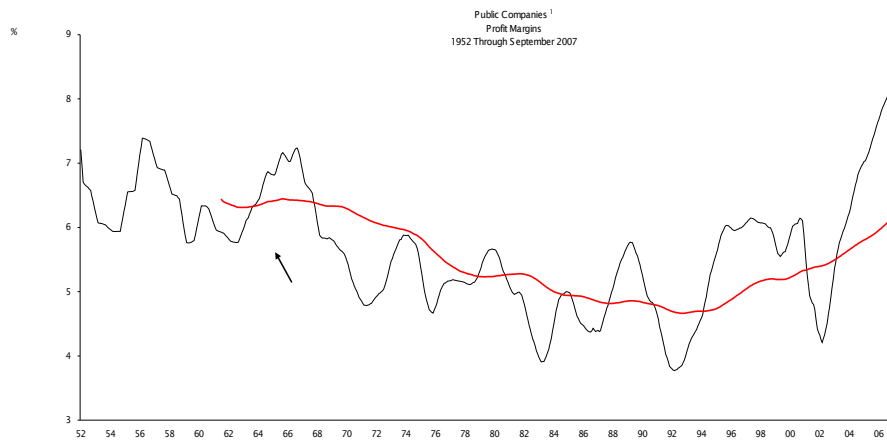
Chart 4



One issue we are studying regarding the declining dollar is what to do with our international exposure going forward. The MSCI EAFE index has posted a gain of 184% for the five years ended October 31. In local market terms, the return was 116%, so the dollar depreciation accounted for over 1/3 of the total return over that time period. Like the stock market, there are a number of positives and negatives for and against the dollar. Simply from a reversion to the mean and sentiment standpoint, the dollar is due a rally at some point. Certainly there are a number of issues that point to a continued weakening of the dollar. The twin deficits, Federal Reserve cutting rates, and China jawboning about diversifying their currency exposure, are but a few of the arguments for continued dollar weakness. We have enjoyed this tailwind in the international portfolio for five years, and do not want to give back those gains.

We continue to stick with our call that large capitalization stocks should outperform small caps. For the calendar year-to-date, large caps as measured by the S&P 500 are running 300 bps higher than small caps. With the economic cycle long in the tooth and earnings growth slowing, large caps have historically outperformed. Also, profit margins are at all time highs, and bigger companies generally have more levers to pull to maintain margins as opposed to smaller companies. The following chart shows profit margins over the past 55 years, and you can see that margins have broken out to new highs.

Chart 5



Source: Corporate Reports, Empirical Research Partners Analysis.

¹ Largest 1,500 stocks, excluding financials and utilities. Data smoothed on a trailing six-month basis.

As far as recent activity, we have been adding to the underweighting in financials for the Core Fund. Given the dramatic selloff across the board in the group, we have been buying on dips in a few names that we think have overshot on the downside. From an asset allocation standpoint, there has been little change within the equity portfolio. We have close to a 1% position in emerging markets with hopes of taking it closer to 3%. We added exposure on the two big downdrafts, one in February and the other in August. We are leery of adding new money to the emerging markets given the large run the past three months. It will be interesting to see if the “decoupling” that has been talked about between the U.S. and the developing economies holds true as many believe.

International Equity Strategy

By Steve Lambdin

The highlight of the third quarter was volatility. After posting a surprisingly large dip in August, most international equity markets rebounded and managed to post a positive gain in the third quarter, thanks to a large slide in the U.S. Dollar. Liquidity fears from the sub-prime mortgage market pushed most markets into turmoil during the quarter. Couple this problem with crude oil prices that are at record levels, and we can see why most investors became more risk adverse during this time. Consumer and business confidence continue to present a risk to the global economy. The U.S. housing industry continued to experience fundamental erosion with little relief seen on the horizon. Investors are left to ponder how this will affect other areas of the U.S. and global economy. However, central banks around the world responded in the quarter with interest rate cuts and massive liquidity injections in an effort to restore some level of normalcy to the credit markets. Global merger and acquisition activity has slowed down tremendously over the last few months, as this activity is not providing the equity tailwinds it once did. However, quite surprisingly, corporate earnings still remain very strong and many parts of the global economy are still performing well. Inflation is manageable at present levels, interest rates are lower, and the global employment picture remains very healthy. When looking at all that happened in the marketplace over the quarter, it is amazing the global equity markets finished in positive territory.

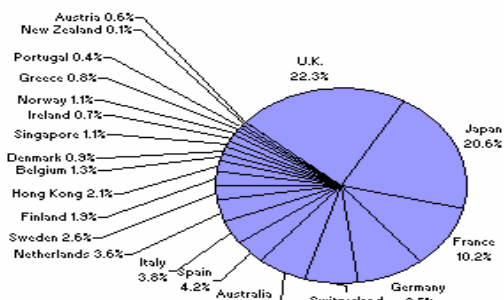
The MSCI EAFE Index (net dividend) returned +2.20% during the quarter vs. +2.03% for the S&P 500 Index. For our fiscal year, the MSCI EAFE Index finished with a nearly a +25% return, well ahead of the +16.5% return of the S&P 500 Index. A falling U.S. Dollar provided a large portion of this outperformance. Within the MSCI EAFE Index, the Asian region outperformed the European region on the strength seen in the Hong Kong and Australian equity markets. The best performing countries were Hong Kong (+23.90%), Finland (+19.00%), and Australia (+11.10%), while Ireland (-12.30%), Austria (-8.40%), and Portugal (-6.20%) were the laggards during the quarter. From an economic sector standpoint, Basic Materials, Telecom, and Technology were areas of strength, while Financials, Consumer Discretionary, and Energy detracted from performance. During the second quarter, the U.S. Dollar fell approximately -5.1% vs. Euro, -1.3% vs. the British Pound, and -6.5% vs. the Japanese Yen. Again, a weak U.S. Dollar was a significant source of positive return for our international equity portfolio.

The table below shows the performance of each EAFE country's national indices broken down between local market return and the USD return during the third quarter of 2007.

**Return Attribution for EAFE Countries
Third Quarter 2007**

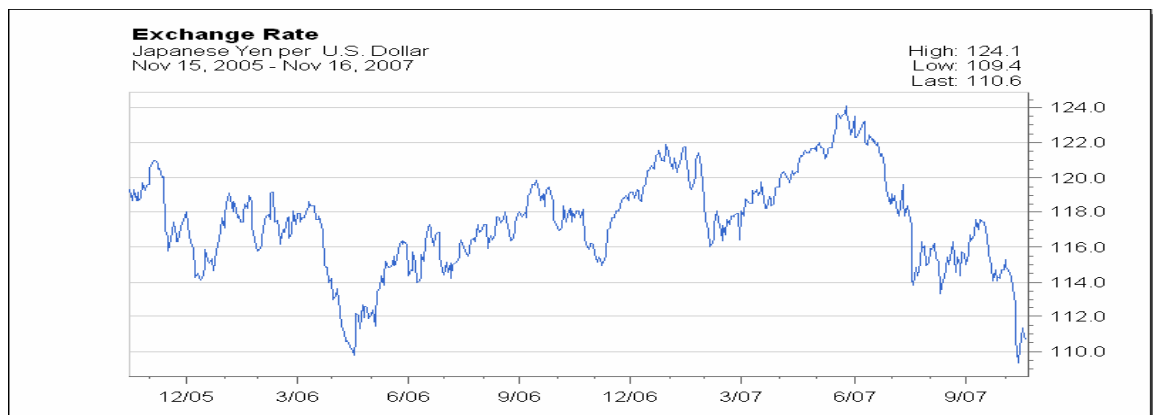
Country	Local Return	Currency Return	USD Return	EAFE Weight
United Kingdom	-1.40%	1.60%	0.20%	22.30%
Japan	-7.70%	6.80%	-0.90%	20.60%
France	-5.50%	5.10%	-0.40%	10.20%
Germany	-1.50%	5.20%	3.70%	8.50%
Switzerland	-3.20%	4.80%	1.60%	6.60%
Australia	6.50%	4.60%	11.10%	6.60%
Spain	-0.20%	5.20%	5.00%	4.20%
Italy	-4.70%	5.00%	0.30%	3.80%
Netherlands	0.00%	5.30%	5.30%	3.60%
Sweden	-3.40%	5.80%	2.40%	2.60%
Hong Kong	23.20%	0.70%	23.90%	2.10%
Finland	13.00%	6.00%	19.00%	1.90%
Belgium	-9.50%	4.70%	-4.80%	1.30%
Singapore	5.70%	3.20%	8.90%	1.10%
Norway	-1.20%	8.80%	7.60%	1.10%
Denmark	3.70%	5.30%	9.00%	0.90%
Greece	5.50%	5.60%	11.10%	0.80%
Ireland	-16.70%	4.40%	-12.30%	0.70%
Austria	-13.00%	4.60%	-8.40%	0.60%
Portugal	-10.90%	4.70%	-6.20%	0.40%
New Zealand	1.30%	-2.30%	-1.00%	0.10%
EAFE	-2.50%	4.70%	2.20%	100.00%

EAFE Country Weights as of September 30, 2007



Thus far in the fourth quarter, most equity markets around the world have experienced some level of weakness. From the end of September through mid-November, the MSCI EAFE Index (net dividend) and the S&P 500 Index are down approximately -1.00% and -4.65%, respectively. Fresh new credit concerns, weakening U.S. economic data points, a continued U.S. housing market “meltdown,” and record high energy prices have come together to push equity markets down and make most investors very nervous. While these issues certainly will slow down the global growth machine of the last few years, we are uncertain whether some countries will be pushed into a recession. Just as we said last quarter, business activity reports and the health of the consumer should be monitored closely for any directional signs they can give investors.

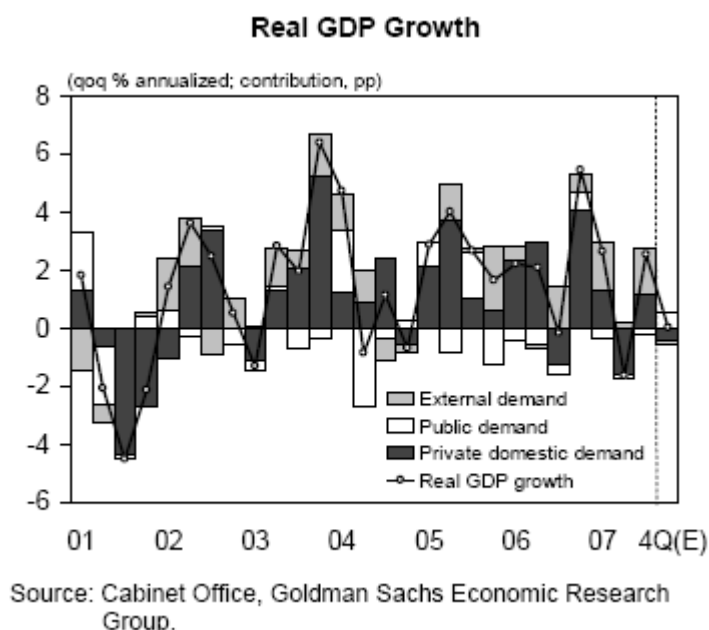
Presented below are some charts showing the movement of various currencies:



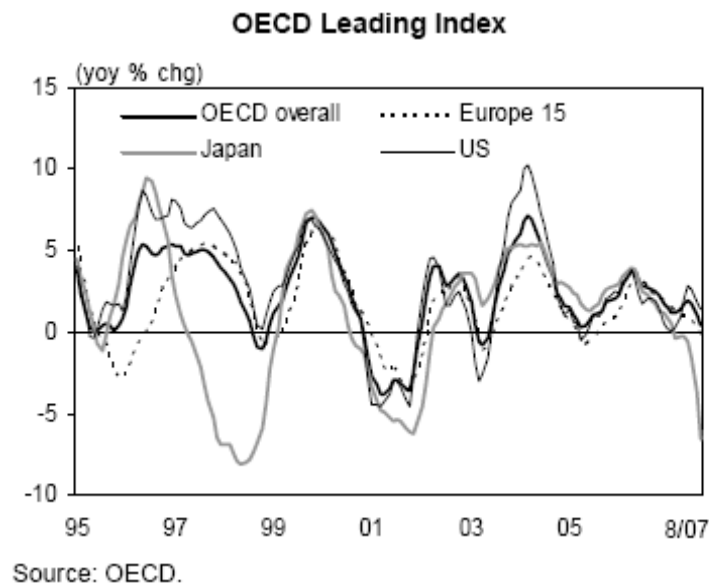
Japan Update

Continuing with what we saw in the previous quarter, the third quarter of 2007 proved to be another period of relatively flat returns. The Nikkei 225 Index fell by -7.1% as less than stellar exports gave rise to uncertainty in the Japanese economy. Also, the effect of a slowing U.S. economy is still being digested by investors in Japanese equities. However, the U.S. Dollar weakened considerably vs. the Japanese Yen, which provided +6.5% of positive return. As we mentioned in the previous quarter, the Japanese “carry trade” continued to unwind, which put pressure on the equity market. Economic data points generally were a bit weaker than what investors expected and will make for a more volatile equity market in the near term. While strong Asian economies continue to support the Japanese economy, it will be hard to overcome a weakening U.S. economy. On the margin, we feel a bit less optimistic about the economy in Japan than we did a few months ago and economic releases to come in the fourth quarter should be very revealing.

Like most investors, we were surprised by Japan's third quarter GDP report. After a revised second quarter GDP contraction of -1.6%, the Japanese economy expanded at a +2.6% pace in the third quarter. This was somewhat better than the consensus estimate. Consumer spending, a source of continued weakness in the economy, was slightly better than the previous quarter. We see exports continuing to weaken, as fourth quarter growth in the U.S. economy could be cut in half from the third quarter. This would be a major headwind for the Japanese economy to overcome, as the U.S. is its main trading partner for exports and domestic demand is only marginally better. This could force Japan's unemployment rate upward as companies try to balance worker needs with expected lower production. In addition, housing starts are declining and Japan's leading economic index has deteriorated in recent months. With this in mind, we could be looking at a Japanese economy that could be weaker than many investors believe over the near term and pushing out any type of meaningful growth well into 2008.



Industrial production in Japan for the third quarter rose approximately +2.2% from the year ago period, which was in line with the second quarter. However, this is a bit deceiving as July and August were very strong months and September's growth showed a noticeable fall off. This was expected as strong readings in July and August did not coincide with the recent weakness being seen in the global economy. September's reading made up for this. Exports are growing at the slowest pace in two years as exports to the U.S. are the culprit behind this. As was the case from the previous quarter, demand from Europe and China are helping to offset weakness in the U.S. We expect production to be weak over the next few months as many economies start to slowdown. Supporting our slowdown thesis are machinery orders that fell -7.6% in September as businesses seem to be curbing spending as the uncertain economic outlook takes hold. Until businesses get comfortable with the current economic climate, we could be looking at a weak capital spending environment.



News on core consumer prices was much the same as it was in the previous quarter. For the third quarter, core consumer prices slid another -0.1%. Japan's large electronics industry continues to experience deflation as flat panel displays, computers, and cameras are more than offsetting price increases in food and retail items. With this data, Japan's Fiscal Policy Minister continues to push out his forecast for an official end to deflation. At this juncture, we still feel that widespread deflation is not that much of an issue as it once was, and higher prices will happen at some point once the economy re-accelerates. While the jobs-to-applicant ratio has ticked down to 1.05 from a recent 1.07 reading, unemployment in September moved up to the 4.0% level, above the recent multi-year lows experienced in June. It is little surprise with the current economic outlook that the unemployment rate has notched upward. With these readings, wage increases will be harder to obtain and consumer spending could be somewhat weaker than expected. The labor situation is not quite as tight as it was during the summer months.

Consumer Sentiment-Related Indicators



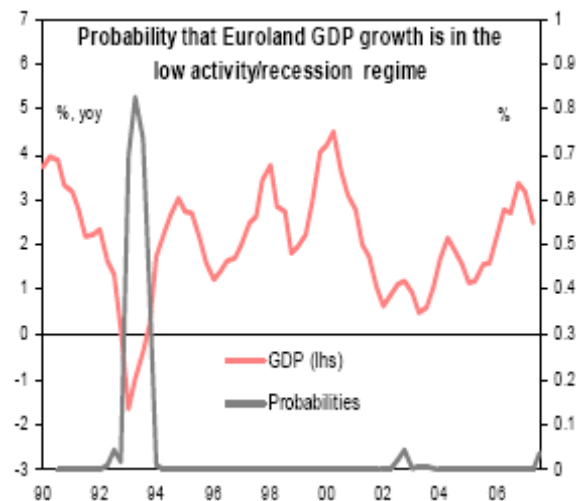
Source: Cabinet Office.

As we review the various economic reports within the Japanese economy, we clearly see an economy that has weakened over the last few months. The climate in the U.S. continues to weaken, which in turn plays havoc with the outlook in Japan. It is this issue that will most likely set the tone for the Japanese economy over the next several months. The consumer will remain very questionable as they have been over the last few years. We don't see much in the way of positive surprises developing here. Most other Asian economies should do reasonably well over the next several months. We expect the Bank of Japan (BOJ) to keep interest rates at present levels, as we see little to no need for any increases at this time. The Japanese equity markets have corrected much more severely than what we have seen in the U.S. With this pullback, valuations look better than they did just a few months ago. However, other than being a bit technically oversold, it is hard to pinpoint just what will bring higher equity prices over the near term. At this point, nervous investors will probably rule the day over the next couple of months. This could keep a lid on any significant upward move in equities at the present time.

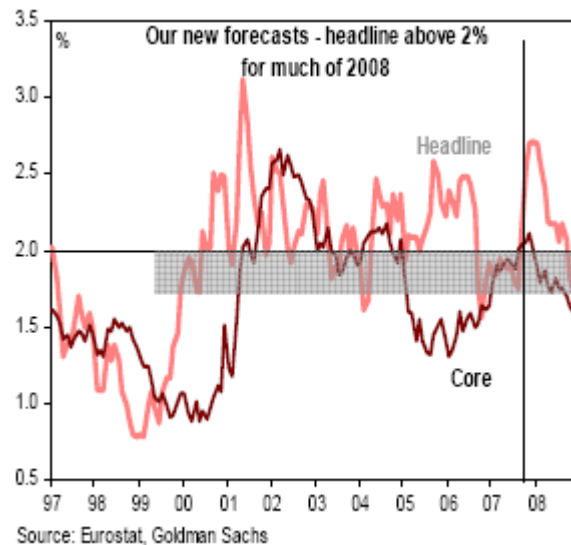
Euroland Update

The equity markets across Euroland in the third quarter were not immune to the wild swings seen in other markets. Extremely weak markets in August gave way to a recovery in September and the MSCI Europe region finished with a +1.7% USD return during the quarter. This was well ahead of what we saw in Japan as well the U.K., but trailed other Asian markets. During the quarter, the European Central Bank (ECB) came to the rescue as they pumped liquidity into the credit crisis. Investors responded just as we would expect, driving equity markets back into positive territory for the quarter. As in the previous quarter, the Euro rose significantly during the quarter to a new all time high against the U.S. Dollar, which provided a significant boost to fairly dismal local market returns. Economic data points were generally weaker than we were expecting in the quarter, which brings us to question the region's outlook going forward. However, on balance, we still feel Euroland economy has a bit better outlook than the U.S. economy, but the situation could change quickly if we fall into a more pronounced period of global slowdown.

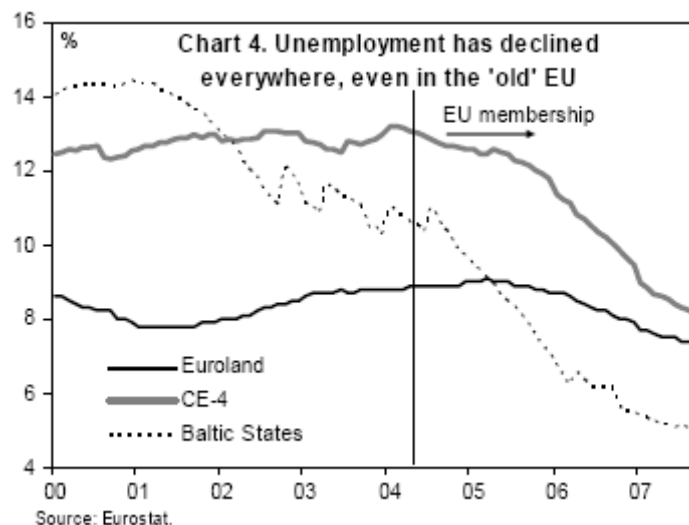
In the third quarter of 2007 GDP rose +2.6% in the Euroland economy from the year ago period. This was slightly ahead of the pace seen in the second quarter. It looks like the Euroland economy was not hit as hard in the third quarter with the issues facing the economy in the U.S. However, rising credit costs, record high oil prices, and a rising Euro have forced most analysts to cut the growth outlook for the economy going forward. With the move we have seen in the Euro and the upward movement in crude oil, inflation has been pushed to the highest levels seen in some time. Consumer spending has been holding up in many countries within the region, providing some positive backdrop to the outlook. Industrial output increased approximately +1.6% during the third quarter, which we feel was not that bad when one considers the economic turmoil being felt in many regions around the world. Nonetheless, growth expectations will have to be brought down as exports to the U.S. could slow more than expected, which would be a meaningful headwind for the Euroland economy relative to last year. We believe investors will be watching for news on the credit crisis in the U.S. for further signs of weakness which could impact the Euroland economy over the near term. This news flow could be one of the main drivers of equity market performance in the coming quarter.



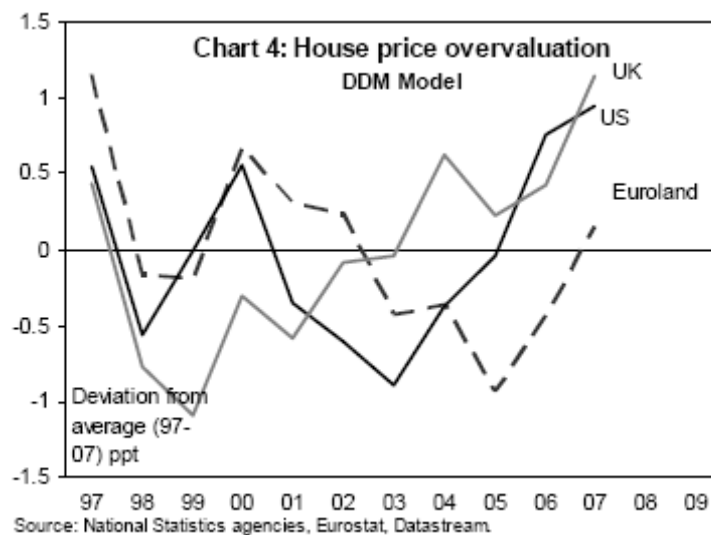
With little surprise as the current credit crisis unfolds, the ECB opted to keep its main lending rate at 4.00% at its September, October, and November meetings. In its recent policy statement, the ECB feels the current reappraisal of risk has led to credit upheaval in the financial markets. With this in mind, it is extremely difficult to warrant an increase in interest rates at this time. The ECB feels that consumption within the Euro region remains decent, while export growth to emerging economic regions remains stellar. This should help offset expected weakness in exports to the U.S. and lay the foundation for near trend growth in the region's economy. Corporate earnings remain quite good and the employment picture continues its long road to recovery. However, just as we mentioned earlier, inflation remains a sticky thorn in the side. The inflation rate remains above levels the ECB feels comfortable with and record high commodity and energy prices present a significant challenge to the economic climate of the region. With these issue in mind, the ECB has changed their assessment of risk over the near to medium term. They feel economic risks are now at a heightened level going forward. In general, we agree with most of what the ECB is communicating. We differ a bit on growth, as we feel the region could be a bit weaker than what they see, but not substantially different. Therefore, we are changing our opinion on interest rates in the region and now feel we will probably not see any rate increases over the near term vs. our previous expectation of a late year hike.



The labor situation continues to be a bright spot in the economic outlook. For the third quarter of 2007, the unemployment rate fell to 7.4% from 7.5% in the second quarter. These figures may look higher than the previous quarter, but are actually lower as the entire series of data was adjusted by Eurostat. This was yet another record low for the region. This was a bit surprising, as consumer and business optimism actually fell in the quarter, but not enough to derail the labor situation. Broad based labor initiatives negotiated in the past continue to be a positive catalyst. Within the Euroland region, Germany continues to make headway with labor, while the country benefits with trade from many emerging economies. We still feel this should put upward pressure on wages as we move forward, but not to the point where it would present a major risk to inflation.



To summarize our thoughts on the Euroland economy, we feel the region will see somewhat slower growth in the near term, but avoid a recession. GDP growth will be slightly below trend as the global credit crisis takes hold. The consumer should hold up well with only some expected marginal weakness. Most watched will be the export market to the U.S. This is simply too early to call and will create a lot of investor anxiety in the coming months. The Euro has risen significantly against the U.S. Dollar over the last year, and is presenting a challenge to the exporters. At this point, we are not forecasting the Euro to continue rising at this pace, but could actually fall back somewhat. Inflation risks remain elevated and will be watched by the ECB. However, any thoughts of raising interest rates will probably be put on hold until we see progress made on restoring confidence in the credit markets. All in all, growth should continue, but at a slower pace. Equities remain at attractive valuations, but probably lack a clear catalyst for any large upward movement over the fourth quarter.

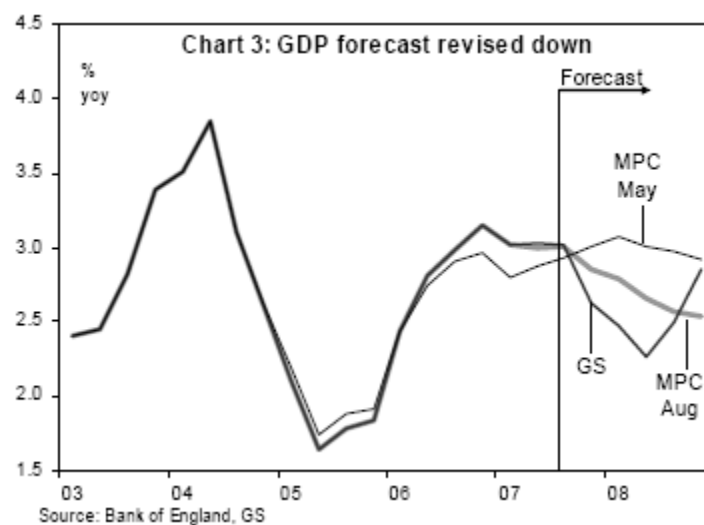


United Kingdom Update

The U.K. equity market took a break from the previous quarter's performance, as the U.K. equity market posted a USD return of only +.20%. Most of the gains in the market were offset as the U.K. mortgage lender, Northern Rock, suffered a liquidity crisis as they were unable to borrow in the interbank market. However, the Bank of England (BOE) took decisive action very quickly to restore liquidity to the market and guaranteed all deposits from customers of Northern Rock in an effort to avert a crisis. Financial stocks rebounded after these actions. Beyond this situation, business conditions remained decent. The British Pound rose to a 26-year high versus the U.S. Dollar which benefited our returns significantly, but this still presents a challenge for the manufacturing side of the U.K. economy. Just as we have in other markets, U.K. equities remain cheap in terms of valuation, but lack a clear catalyst for any significant upward movement over the near term.

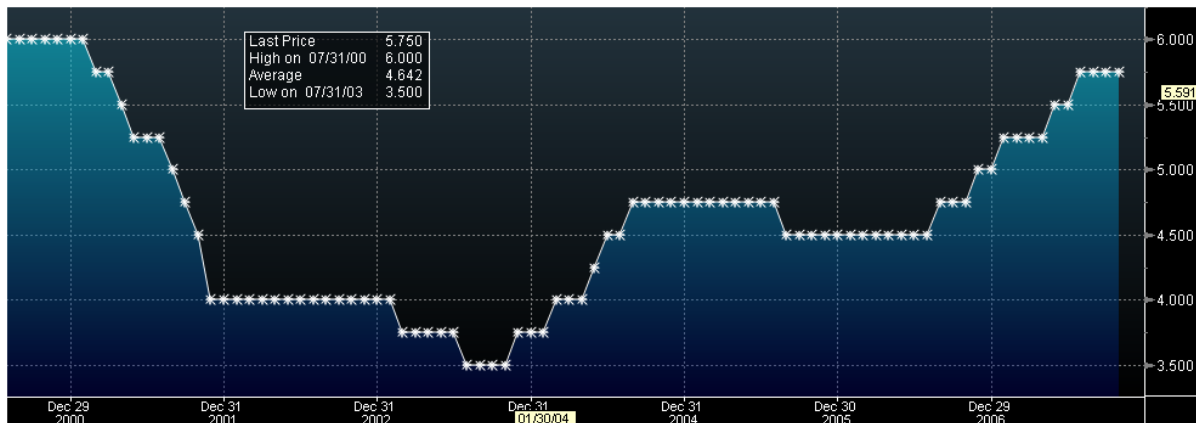
The U.K. economy continued to surprise many in the third quarter of 2007. Third quarter GDP rose +0.8% from the previous quarter, or +3.3% on a year over year basis. This was a slight upside surprise versus what the market was anticipating. The services side of the economy, which makes up three-quarters of the economy, shielded weakness on the manufacturing side. We still see the U.K. economy as one of the fastest growing among

the G-7 countries for 2007. Business services, such as financials, airlines, and healthcare performed quite well during the quarter. Housing prices fell at the fastest pace in nearly two years toward the end of the third quarter. Further weakness seems inevitable in the coming months. Manufacturing slipped a bit from the previous quarter as most manufacturers of equipment are suffering from the British Pound's sharp upward movement against a basket of most currencies. This makes it even harder to compete in an already weak environment. Retail sales continued to be stellar and grew approximately +5% year over year during the quarter. Evidence of significant discounting seems to have brought consumers out in force during the quarter. Heading into the fourth quarter, we feel it is only logical to see the services side of the economy slow down from the pace we have seen recently, as the credit crisis takes hold in the U.K. and interest rates remain somewhat elevated relative to other economies. As we know, financial services are a large part of this economy. We must be watchful to see how this will affect the consumer over the coming months.



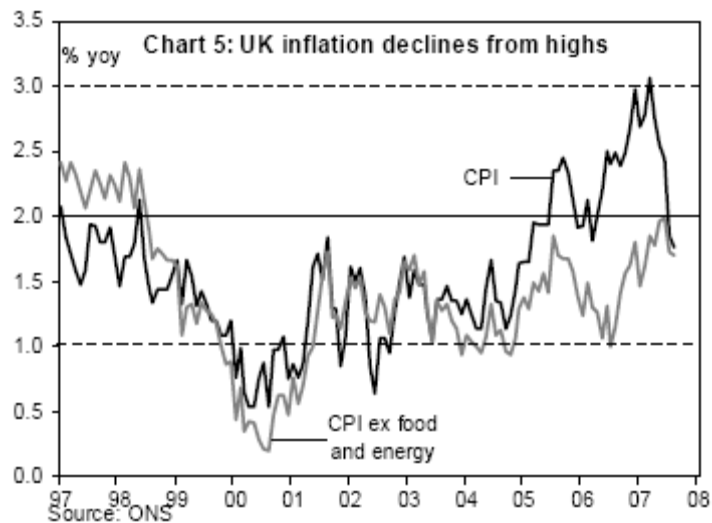
At its November policy meeting, the BOE opted to leave interest rates unchanged at 5.75%. This rate has been unchanged since the BOE raised rates to this level in July. The key repurchase rate remains at the highest level we have seen since 2001. This action is a bit surprising as the credit contagion seems to have spread over to the U.K. as a run on Northern Rock, a U.K. bank, took over financial headlines during the quarter. This shows how concerned the Monetary Policy Committee (MPC) is over inflation, as higher oil prices could send inflation above the committee's acceptable target level. The MPC has stated that the bank should not cut interest rates just to "insulate the banking system". We feel this is too much of a "hard-line" approach to take at this juncture, as the MPC should stand ready to take action to avert a financial panic in the U.K. based on the needs in the economy at the present time. In addition, risks to further economic growth clearly lie on the downside, as growth should slowdown from the pace in previous quarters. To us, recent inflation readings around the 2% level just don't seem to justify this stance. Therefore with these issues in mind, we feel the BOE will change course and cut interest rates sometime over the next couple of months in an effort to provide a bit of stimulus into a weakening economic climate.

Bank of England Repurchase Rate



The employment situation continues to be a strong area in the U.K. economy during the third quarter of 2007. Using ILO standards, the unemployment rate in the third quarter remained at 5.4%, the same level as the previous quarter. This remains at the lowest levels in a couple of years. Jobless claims have dropped recently and wage growth has accelerated recently to the 3.7% area, as total employment remains over 29 million workers. Many employee recruiting companies continue to see decent levels of activity at this juncture. Highly skilled technical workers remain in greatest demand. As one would expect, it is the services side of the economy that continues to be the employment growth engine. However, with the ongoing debacle unfolding in the financial services industry, we feel a few cracks could develop in the employment picture such as a lid on wage growth and an increase in unemployed workers, but a major widespread problem should not develop.

As we look at the rest of 2007 and into 2008, we expect the economy to cool off from the pace seen for most of 2007. Growth will continue, but at a slower rate. The U.K. economy will not be completely immune to economic weakness being felt in other large economies. The credit crisis will be felt in the U.K. as its large financial services footprint weakens. Housing will almost certainly weaken further from here as well. Interest rates should come down which could help soften the blow slightly. The manufacturing outlook continues to be weak, as a 26-year high the British Pound vs. the U.S. Dollar will probably be too much to overcome. However, we still feel the U.K. economy could post better growth than many other countries in the G-7 as the service side provides a buffer. Inflation will probably hover right around the BOE's 2% target over the near term. As for the equity markets, valuations still look attractive, but earnings growth will slowdown, muting some of the upside as financial services stocks should have a hard time in the fourth quarter.



International Equity Activity/Strategy

The third quarter of 2007 proved to be a “choppy” time for international equities. The global credit crisis and the subsequent re-pricing of risk continue to make global headlines nearly everyday. This global credit crunch has certainly affected investor confidence. Equity volatility was quite high this quarter and just may be a sign of the landscape ahead of us. Crude oil prices continue to be an investor headwind, as prices have moved up into the mid to upper \$90’s a barrel. Another concern is the rapidly deteriorating U.S. housing market. Sub-prime concerns and global liquidity issues are dominating the financial news flow in the U.S. and Europe. With these concerns in place, we feel the global economy will slow down from the pace seen in the last few years, but still manage to post decent growth going forward. At this point, we feel the U.S. and most other major economies of the world will remain out of a recession. On the positive side, the global infrastructure “buildout” continues to be a major factor going forward and a growth catalyst. Interest rates could fall in many parts of the world as central banks stand ready to react very quickly in order to maintain plenty of liquidity to the marketplace. Global employment remains very healthy and inflation appears to be manageable. Last line cash flows remain resilient, providing plenty of opportunities for growth. Even though growth has slowed a bit, equity valuations still look quite attractive in most parts of the world.

We have not made any incremental investments into or out of our international equity portfolio since our last update. At this point, with the U.S. Dollar’s significant fall over the last few years, which has provided a significant boost to our international equity returns, we feel it may be prudent to begin at looking to hedge a portion of our currency exposure. This would protect the portfolio from a reversal of sentiment toward the U.S. Dollar. Also, we will continue to look for opportunities to increase our exposure to large cap international equities as well as emerging market equities if we feel the markets give us an ample opportunity to do this. However, we will remain cautious and disciplined if we undertake any of these actions. Our total allocation to international equities is approximately 17% of total TRS and ERS assets and nearly 9.2% of the JRF total assets. Therefore, we expect to have a weighting to this asset class in the 15% to 19% range over the near term. (Charts provided by Factset ,Goldman Sachs, ONS, Bloomberg, Bank of England, National Statistics Agency, Datastream, IDS, Eurostat, Cabinet Office, MIC, MHLW, OECD)

TEACHERS RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

RATES OF RETURN - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
TRS CORE FUND	2,104,019,214	3.55	1.89	9.84	17.37	17.37	13.48	16.42	4.68	Oct-94
TRS GOLDMAN SACHS GROUP INC	584,749,347	2.58	2.14	7.29	11.63	11.63				Aug-06
TRS S&P 500 FUND	5,309,034,906	3.74	2.05	9.17	16.51	16.51	13.26	15.53	6.70	Oct-94
TRS S&P MID CAP INDEX	946,801,563	2.63	-0.86	11.04	18.62	18.62	15.61	18.14	11.62	Oct-94
TRS S&P SMALL CAP INDEX	468,767,822	1.46	-1.86	6.49	14.86	14.86	14.01	18.41		Mar-01
TRS SMALLCAP ACTIVE FUND	84,782,464	0.31	-6.27	6.98	15.39	15.39				Jun-06
TRS SPECIAL SITUATIONS	496,721,876	2.51	-2.21	8.27	18.38	18.38	16.81	18.19	8.08	Oct-94
TRS TOTAL DOMESTIC EQUITY	9,994,877,192	3.33	1.26	9.18	16.60	16.60	13.66	16.16	6.42	Oct-91
TRS CUSTOM DOMESTIC EQUITY INDEX		3.45	1.38	9.26	16.69	16.69	13.60	16.09		
S&P 500		3.74	2.03	9.13	16.44	16.44	13.14	15.45	6.57	
S&P 400 MIDCAP		2.65	-0.87	11.00	18.76	18.76	15.63	18.17	11.60	
S&P 600 SMALL CAP		1.49	-1.83	6.58	14.93	14.93	14.29	18.73	9.41	
<u>INTERNATIONAL EQUITY</u>										
TRS ALLEGRO INVESTMENT CORP SA	77,211,672	4.13	4.21							Mar-07
TRS MORGAN STANLEY PLUS NOTES MSCI	77,114,990	3.68	3.40							Mar-07
TRS I-SHARES EEM NOTE	35,018,880	1.96								Aug-07
TRS INTERNATIONAL EQUITIES	3,562,329,265	5.35	2.40	13.40	25.22	25.22	23.48	23.93	8.53	Nov-94
TRS TOTAL INTERNATIONAL EQUITY	3,751,674,807	5.26	2.50	13.59	25.43	25.43	23.55	23.97	8.54	Oct-94
MSCI EAFE (NET)		5.35	2.18	13.15	24.86	24.86	23.24	23.55	7.97	
TRS TOTAL GLOBAL EQUITY	13,746,551,999	3.85	1.60	10.34	18.84	18.84	15.98	17.92	7.99	Oct-75
TRS CUSTOM GLOBAL EQUITY INDEX		3.97	1.61	10.29	18.76	18.76	15.85			

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	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>FIXED INCOME</u>										
TRS DOMESTIC FIXED INCOME	2,518,729,943	0.65	3.04	4.50	5.90	5.90	5.41	6.60		Aug-99
TRS CUSTOM DOMESTIC FIXED INDEX		0.80	2.75	3.72	4.99	4.99	3.67	4.69		
CITIGROUP NON-US WGBI		2.95	8.10	7.26	9.50	9.50	4.84	7.98	5.75	
TRS TOTAL FIXED (ex. Private Placements)	2,518,729,943	0.65	3.04	4.48	5.92	5.92	5.41			Oct-03
TRS CUSTOM GLOBAL FIXED INDEX		0.80	2.75	3.70	4.97	4.97	3.67			
TRS PRIVATE PLACEMENTS	2,912,310,199	0.99	2.26	27.80	30.49	30.49	12.75	11.21		Aug-99
TRS CASH ACCOUNT	96,180,679	0.68	1.59	4.73	6.11	6.11	4.49			Sep-03
TRS TOTAL FIXED INCOME	5,527,220,821	0.83	2.58	15.66	17.66	17.66	8.84	8.79	7.16	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
TRS TOTAL ALTERNATIVES	2,506,380,898	3.13	3.42	8.96	9.47	9.47	4.70			Oct-03
TRS TOTAL F.I. PLUS ALTERNATIVES	8,033,601,719	1.53	2.82	13.61	15.15	15.15	7.66	7.71	6.63	Oct-93

TEACHERS RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

RATES OF RETURN - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>TOTAL PLAN</u>										
TRS TOTAL PLAN POLICY		2.91	1.51	7.74	13.70	13.70	11.15			
TRS TOTAL PLAN	21,780,153,719	2.98	2.06	11.56	17.46	17.46	12.46	12.94	7.42	Oct-88

EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
ERS CORE FUND	1,052,034,267	3.60	1.68	10.00	17.58	17.58	13.49	16.38	4.63	Oct-94
ERS GOLDMAN SACHS GROUP INC	263,653,403	2.58	2.14	7.29	11.63	11.63				Aug-06
ERS S&P 500 FUND	2,412,102,470	3.74	2.05	9.17	16.51	16.51	13.38	15.58	6.72	Oct-94
ERS S&P MID CAP INDEX	419,471,460	2.63	-0.85	11.04	18.59	18.59	15.63	18.18	11.65	Oct-94
ERS S&P SMALL CAP INDEX	192,753,122	1.46	-1.85	6.51	14.87	14.87	14.29	18.45		Mar-01
ERS SMALLCAP ACTIVE FUND	41,759,664	0.31	-6.27	6.97	15.39	15.39				Jun-06
ERS SPECIAL SITUATIONS	266,719,968	2.51	-2.20	8.29	18.44	18.44	17.02	18.29	8.04	Oct-94
ERS TOTAL DOMESTIC EQUITY	4,648,494,353	3.34	1.21	9.23	16.68	16.68	13.74	16.20	6.45	Oct-93
<i>ERS CUSTOM DOMESTIC EQUITY INDEX</i>		3.46	1.39	9.28	16.71	16.71	13.58	16.06		
<i>S&P 500</i>		3.74	2.03	9.13	16.44	16.44	13.14	15.45	6.57	
<i>S&P 400 MIDCAP</i>		2.65	-0.87	11.00	18.76	18.76	15.63	18.17	11.60	
<i>S&P 600 SMALL CAP</i>		1.49	-1.83	6.58	14.93	14.93	14.29	18.73	9.41	
<u>INTERNATIONAL EQUITY</u>										
ERS ALLEGRO INVESTMENT CORP SA	36,877,250	4.13	4.21							Mar-07
ERS MORGAN STANLEY PLUS NOTES MSCI	36,831,040	3.68	3.40							Mar-07
ERS I-SHARES EEM NOTE	18,877,365	1.96								Aug-07
ERS INTERNATIONAL EQUITIES	1,564,657,960	5.36	2.42	13.45	25.27	25.27	23.46	23.90	8.54	Nov-94
ERS TOTAL INTERNATIONAL EQUITY	1,657,243,615	5.25	2.53	13.66	25.50	25.50	23.54	23.95	8.56	Oct-94
<i>MSCI EAFE (NET)</i>		5.35	2.18	13.15	24.86	24.86	23.24	23.55	7.97	
ERS TOTAL GLOBAL EQUITY	6,305,737,968	3.84	1.56	10.36	18.84	18.84	15.95	17.89	7.95	Oct-93
<i>ERS CUSTOM GLOBAL EQUITY INDEX</i>		3.95	1.60	10.26	18.69	18.69	15.76			

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EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>FIXED INCOME</u>										
ERS DOMESTIC FIXED INCOME	1,145,769,056	0.65	3.05	4.51	5.93	5.93	5.46	6.75		Sep-99
ERS CUSTOM DOMESTIC FIXED INDEX		0.80	2.74	3.72	5.00	5.00	3.67	4.70		
CITIGROUP NON-US WGBI		2.95	8.10	7.26	9.50	9.50	4.84	7.98	5.75	
ERS TOTAL FIXED (ex. Private Placements)	1,145,769,056	0.65	3.05	4.49	5.96	5.96	5.46			Oct-03
ERS CUSTOM GLOBAL FIXED INDEX		0.80	2.74	3.70	4.98	4.98	3.67			
ERS PRIVATE PLACEMENTS	1,423,670,634	1.00	2.26	28.41	31.19	31.19	12.80	11.14		Aug-99
ERS CASH ACCOUNT	51,726,130	0.67	1.57	4.99	6.38	6.38	4.59			Sep-03
ERS TOTAL FIXED INCOME	2,621,165,820	0.84	2.58	16.27	18.34	18.34	8.94	8.90	7.15	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
ERS TOTAL ALTERNATIVES	1,397,402,334	2.71	2.95	12.30	12.76	12.76	5.87			Oct-03
ERS TOTAL F.I. PLUS ALTERNATIVES	4,018,568,154	1.48	2.69	14.94	16.48	16.48	8.07	7.89	6.65	Oct-93

EMPLOYEE RETIREMENT OF ALABAMA

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>TOTAL PLAN</u>										
ERS TOTAL PLAN POLICY		2.87	1.49	7.63	13.51	13.51	10.86			
ERS TOTAL PLAN	10,324,306,122	2.91	2.02	12.15	17.92	17.92	12.35	12.86	7.27	Oct-93

JUDICIAL RETIREMENT FUND

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
For Everything You Invest In™

SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
<u>U.S. EQUITY</u>										
JRF S&P 500 FUND	136,553,481	3.74	2.05	9.48	16.77	16.77	13.29	15.54	6.72	Oct-94
JRF S&P MID CAP INDEX	12,102,061	2.66	-0.83	11.09	18.75	18.75	15.67	18.29	11.68	Oct-94
JRF S&P SMALL CAP INDEX	4,229,613	1.46	-1.85	6.46	14.82	14.82	14.37	18.62		Mar-01
JRF TOTAL DOMESTIC EQUITY	152,885,154	3.59	1.71	9.53	16.89	16.89	13.52	15.86	7.16	Oct-93
<i>JRS CUSTOM DOMESTIC EQUITY INDEX</i>		3.59	1.68	9.19	16.56	16.56	13.37	15.77		
<i>S&P 500</i>		3.74	2.03	9.13	16.44	16.44	13.14	15.45	6.57	
<i>S&P 400 MIDCAP</i>		2.65	-0.87	11.00	18.76	18.76	15.63	18.17	11.60	
<i>S&P 600 SMALL CAP</i>		1.49	-1.83	6.58	14.93	14.93	14.29	18.73	9.41	
<u>INTERNATIONAL EQUITY</u>										
JRF ALLEGRO INVESTMENT CORP SA	1,152,391	4.13	4.21							Mar-07
JRF MORGAN STANLEY PLUS NOTES MSCI	1,150,970	3.68	3.40							Mar-07
JRF I-SHARES EEM NOTE	820,755	1.96								Aug-07
JRF INTERNATIONAL EQUITIES	21,722,511	5.37	2.26	13.46						Nov-06
JRF TOTAL INTERNATIONAL EQUITY	24,846,626	5.12	2.55	13.95						Nov-06
<i>MSCI EAFE (NET)</i>		5.35	2.18	13.15	24.86	24.86	23.24	23.55	7.97	
JRF TOTAL GLOBAL EQUITY	177,731,780	3.80	1.83	10.09	17.89	17.89	13.84	16.06	7.25	Oct-93
<u>DOMESTIC FIXED INCOME</u>										
JRF DOMESTIC FIXED INCOME	56,331,292	0.59	3.01	4.39	5.94	5.94	4.90	3.97	4.82	Oct-93
<i>JRF CUSTOM DOMESTIC FIXED INDEX</i>		0.80	2.83	3.84	5.10	5.10	3.69	4.96		

JUDICIAL RETIREMENT FUND

SUMMARY OF PERFORMANCE

RATES OF RETURN

PERIODS ENDING September 30, 2007



STATE STREET.
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SUMMARY OF PERFORMANCE - GROSS OF FEE

	MKT VALUE	1 Month	3 Month	CYTD	FYTD	1 Year	3 Years	5 Years	10 YEARS	Fund Inception date
JRF PRIVATE PLACEMENTS	8,993,724	1.53	4.46	16.50	19.26	19.26	16.58	13.60		Oct-01
JRF CASH ACCOUNT	4,885,832	0.43	1.33	4.01	5.39	5.39	4.25			Sep-03
JRF TOTAL FIXED INCOME	70,210,849	0.70	3.05	5.88	7.59	7.59	6.93	5.58	5.63	Oct-93
<u>ALTERNATIVE INVESTMENTS</u>										
JRF TOTAL ALTERNATIVES	21,604,524	0.96	1.80	4.19	5.41	5.41	4.28			Oct-03
JRF TOTAL F.I. PLUS ALTERNATIVES	91,815,372	0.76	2.72	5.53	7.16	7.16	6.49	5.34	5.51	Oct-93
<u>TOTAL PLAN</u>										
<i>JRF TOTAL PLAN POLICY</i>		2.91	1.92	7.94	13.66	13.66	10.00			
JRF TOTAL PLAN	269,547,153	2.74	2.15	8.65	14.27	14.27	11.08	11.26	6.73	Oct-93